

APPENDIX A



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Suburban Water Systems

(A wholly owned subsidiary of SouthWest Water Company)

Financial Statements

December 31, 2021 and 2020

Suburban Water Systems
(A wholly owned subsidiary of SouthWest Water Company)
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December 31, 2021 and 2020

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Report of Independent Auditors

To the Board of Directors of
Suburban Water Systems

Opinion

We have audited the accompanying financial statements of Suburban Water Systems (the “Company”), which comprise the balance sheets as of December 31, 2021 and 2020, and the related statements of income and retained earnings and cash flows for the years then ended, including the related notes (collectively referred to as the “financial statements”).

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2021 and 2020, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (US GAAS). Our responsibilities under those standards are further described in the Auditors’ Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of the Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the Company’s ability to continue as a going concern for one year after the date the financial statements are available to be issued.

Auditors’ Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors’ report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with US GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material



if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with US GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the Company's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control-related matters that we identified during the audit.

PricewaterhouseCoopers LLP

Houston, Texas
April 14, 2022

Suburban Water Systems
(A wholly owned subsidiary of SouthWest Water Company)
Balance Sheets
December 31, 2021 and 2020

<i>(in thousands of dollars)</i>	2021	2020
Assets		
Utility property, plant and equipment, at cost	\$ 391,004	\$ 361,607
Less accumulated depreciation	<u>(138,547)</u>	<u>(129,515)</u>
Utility property, plant and equipment, net	<u>252,457</u>	<u>232,092</u>
Current assets		
Cash and cash equivalents	140	256
Accounts receivable, net	7,560	8,354
Regulatory assets (short term) - (Note 2)	7,386	5,354
Other current assets (Note 4)	<u>4,400</u>	<u>6,564</u>
Total current assets	<u>19,486</u>	<u>20,528</u>
Other assets		
Regulatory assets (Note 2)	29,940	26,840
Goodwill	1,826	1,826
Other long-term assets (Note 5)	<u>8,453</u>	<u>7,877</u>
Total other assets	<u>40,219</u>	<u>36,543</u>
Total assets	<u>\$ 312,162</u>	<u>\$ 289,163</u>
Capitalization and Liabilities		
Capitalization		
Common stockholder's equity		
Common stock	\$ 745	\$ 745
Capital surplus	27,425	27,425
Retained earnings	<u>102,882</u>	<u>97,841</u>
Total common stockholder's equity	131,052	126,011
Cumulative preferred stock	3,982	3,982
Long-term debt, less unamortized debt issuance costs of \$609 and \$690, respectively	<u>81,391</u>	<u>89,310</u>
Total capitalization	<u>216,425</u>	<u>219,303</u>
Current liabilities		
Accounts payable	2,851	3,078
Related party payable to parent company	17,402	-
Regulatory liabilities (short term) - (Note 2)	22	140
Current portion of long-term debt	8,000	-
Other current liabilities (Note 7)	<u>12,551</u>	<u>11,794</u>
Total current liabilities	<u>40,826</u>	<u>15,012</u>
Other liabilities and deferred credits		
Advances for construction	7,459	7,766
Contributions in aid of construction	13,570	14,150
Developer deposits	9,132	8,778
Deferred income taxes (Note 8)	14,528	13,586
Regulatory liabilities (Note 2)	9,664	9,956
Other long-term liabilities (Note 7)	<u>558</u>	<u>612</u>
Total other liabilities and deferred credits	<u>54,911</u>	<u>54,848</u>
Commitments and contingencies (Note 11)		
Total capitalization and liabilities	<u>\$ 312,162</u>	<u>\$ 289,163</u>

The accompanying notes are an integral part of these financial statements.

Suburban Water Systems
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Statements of Income and Retained Earnings
Years Ended December 31, 2021 and 2020

<i>(in thousands of dollars)</i>	2021	2020
Operating revenues	\$ 99,416	\$ 93,521
Operating expenses and taxes		
Purchased water and power, including production cost balancing accounts	36,208	29,900
Other operating expense	27,992	28,638
Depreciation and amortization	11,710	10,764
Taxes		
Income	3,603	3,287
Payroll and local	1,976	1,880
Property	1,957	1,946
Total operating expenses and taxes	<u>83,446</u>	<u>76,415</u>
Utility operating income	<u>15,970</u>	<u>17,106</u>
Other income (expense)		
Interest expense and amortization of deferred debt issuance cost	(4,844)	(5,434)
Interest income	75	103
Total other income (expense)	<u>(4,769)</u>	<u>(5,331)</u>
Net income	<u>\$ 11,201</u>	<u>\$ 11,775</u>
Beginning retained earnings	\$ 97,841	\$ 92,543
Plus net income	<u>11,201</u>	<u>11,775</u>
Less dividends paid		
Series A preferred	(115)	(115)
Series B preferred	(54)	(54)
Total preferred dividends paid	<u>(169)</u>	<u>(169)</u>
Common dividends paid	<u>(5,991)</u>	<u>(6,308)</u>
Total dividends paid	<u>(6,160)</u>	<u>(6,477)</u>
Ending retained earnings	<u>\$ 102,882</u>	<u>\$ 97,841</u>

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Suburban Water Systems
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Statements of Cash Flows
Years Ended December 31, 2021 and 2020

<i>(in thousands of dollars)</i>	2021	2020
Cash flows from operating activities		
Net income	\$ 11,201	\$ 11,775
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	11,710	10,764
Deferred income taxes	942	(1,008)
Provision for doubtful accounts	76	155
Amortization of deferred financing fees	81	82
Changes in assets and liabilities		
Accounts receivable	718	(2,443)
Regulatory assets	(5,132)	(1,151)
Other current assets	2,164	4,616
Other assets	(561)	204
Accounts payable	566	(399)
Other current liabilities	688	4,253
Regulatory liabilities	(410)	(742)
Other	(1,727)	(2,352)
Net cash provided by operating activities	<u>20,316</u>	<u>23,754</u>
Cash flows from investing activities		
Additions to property, plant, and equipment	(32,296)	(22,914)
Purchase of water rights	(15)	(1,678)
Net cash used in investing activities	<u>(32,311)</u>	<u>(24,592)</u>
Cash flows from financing activities		
Payment for deferred financing costs	-	(60)
Dividends paid	(6,160)	(6,477)
Receipts of deposits, advances for construction	1,216	1,647
Payments on deposits and advances for construction	(579)	(483)
Advances from Parent	17,402	5,966
Net cash provided by financing activities	<u>11,879</u>	<u>593</u>
Net decrease in cash and cash equivalents	(116)	(245)
Cash and cash equivalents at the		
Beginning of year	<u>256</u>	<u>501</u>
End of year	<u>\$ 140</u>	<u>\$ 256</u>
Supplemental disclosure of cash flow information		
Cash paid during the year for interest	\$ 4,517	\$ 4,532
Noncash contribution of related party payable to equity	-	22,408
Noncash contributions in aid of construction	-	85
Change in capital items in accounts payable	(792)	1,764

The accompanying notes are an integral part of these financial statements.

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1. Description of Business

Whittier Water Company was incorporated on April 18, 1907 and the name was changed to Suburban Water Systems on August 25, 1953. Suburban Water Systems (the “Company” or “SWS”) provides a broad range of services, including water production, treatment, and distribution. The service territory of Suburban is in the San Jose Hills (SJH) and Whittier La-Mirada (WLM) areas of Southern California.

The Company is a regulated utility and is a wholly owned subsidiary of SouthWest Water Company (the “Parent” or “SouthWest”).

2. Summary of Significant Accounting Policies

Basis of Presentation and Use of Estimates

The financial statements include the accounts of Suburban Water Systems and have been prepared in conformity with accounting principles generally accepted in the United States of America, also referred to as the Accounting Standards Codification (“ASC”), giving recognition to the ratemaking and accounting practices of the California Public Utilities Commission (“CPUC”).

The preparation of the financial statements in conformity with the ASC requires management to make estimates and assumptions. The reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period could be affected by both changes in those estimates and actual results.

The current novel coronavirus (“COVID-19”) pandemic has caused significant social and economic restrictions that have been imposed in the United States and abroad, which has resulted in significant volatility in the global economy and led to reduced economic activity in some industries. In the preparation of these financial statements and related disclosures, the Company has assessed the impact that the COVID-19 pandemic has had on its estimates, assumptions, forecasts, and accounting policies. Because of the essential nature of its business, the Company does not believe the COVID-19 pandemic had a material impact on its estimates, assumptions and forecasts used in the preparation of its financial statements. As the COVID-19 situation is unprecedented and ever evolving, future events and effects related to the COVID-19 pandemic cannot be determined with precision, and actual results could significantly differ from estimates or forecasts.

Regulated Utility Accounting

The Company is a regulated utility and is subject to regulation by the CPUC. The CPUC has allowed recovery of costs and required the refund of credits which the Company has recorded as regulatory assets and liabilities. In accordance with “utility accounting” as prescribed by ASC 980, costs and credits on the balance sheet are deferred as regulatory assets and liabilities when it is probable that future revenue or expense in an amount at least equal to the capitalized cost or credit will result from inclusion of those costs or credits in allowable costs for ratemaking purposes. Except for income taxes, regulatory assets are excluded from the Company’s rate base and do not earn a return; although, as approved by regulators, the Company accrues interest at the 90-day nonfinancial commercial paper rate for future surcharging/surcrediting customers. In the event that the assessment as to the probability of the inclusion in the ratemaking process changes, the

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associated regulatory asset or liability would be adjusted to reflect the change in assessment or change in regulatory approval.

The regulatory assets and liabilities included on the balance sheets as of December 31, 2021 and 2020 are shown in the following table:

<i>(in thousands of dollars)</i>	2021	2020
Regulatory assets		
Short term		
Supply cost balancing account	\$ 2,024	\$ 2,024
COVID-19 financial impacts	2,018	-
Interim rates	3,344	3,330
Total short term	<u>7,386</u>	<u>5,354</u>
Long term		
Regulatory tax assets	9,944	9,527
Supply cost balancing account	8,232	10,979
COVID-19 financial impacts	555	1,221
Regulatory assets-other	11,209	5,113
Total long term	<u>29,940</u>	<u>26,840</u>
Total regulatory assets	<u>37,326</u>	<u>32,194</u>
Regulatory liabilities		
Short term		
Regulatory tax liability	22	140
Total short term	<u>22</u>	<u>140</u>
Long term		
Regulatory tax liability	8,153	8,434
Drought surcharge regulatory liability	254	254
Regulatory liabilities-other	1,257	1,268
Total long term	<u>9,664</u>	<u>9,956</u>
Total regulatory liabilities	<u>9,686</u>	<u>10,096</u>
Net regulatory assets	<u>\$ 27,640</u>	<u>\$ 22,098</u>

The Company continues to monitor the global outbreak of the COVID-19 pandemic. To date, the Company has experienced COVID-19 financial impacts, including an increase in uncollectible accounts expense and certain incremental operation and maintenance expenses. These impacts are collectively referred to as “financial impacts.” The Company has a CPUC approved Catastrophic Event Memorandum Account (CEMA). The CEMA allows the Company to track and recover certain financial impacts related to the COVID-19 pandemic. The Company recorded \$2.6 million in regulatory assets to its CEMA for the financial impacts related to the COVID-19 pandemic as of December 31, 2021. The Company believes that this regulatory asset is probable for recovery through future regulatory proceedings. In February 2022, the Company received \$2.0 million for recovery of some of these regulatory assets.

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In January 2017, SWS filed an application for a general rate increase (“GRC”) with the CPUC for authority to increase rates charged for water service in 2018, 2019, and 2020. The scheduled January 2018 effective date of new rates and the January 2019 effective date of the 2018 step filing were delayed by the CPUC. In December 2017, the CPUC approved an interim rates memorandum account to track the difference between the interim rates (which represented existing rates) and the final adopted rates effective January 2018. In May 2019, the CPUC issued Decision No. 19-05-029 adopting the GRC for years 2018, 2019, and 2020. The decision resulted in an overall rate increase of \$4.86 million or 6.40% for 2018, \$2.2 million or 2.72% for 2019, and \$2.2 million for 2020. The decision also authorized SWS to recover the revenue associated with the delay in adopting new 2018 and 2019 rates (the difference between the interim rates and the adopted rates). As of December 31, 2020, the regulatory asset related to the interim rates under-collection is approximately \$3.3 million.

In March 2020, SWS filed an application for a general rate increase (“GRC”) with the CPU for authority to increase rates charged for water service in 2021, 2022, and 2023. The scheduled January 2021 effective date of new rates was delayed by the CPUC. In December 2020, the CPUC approved an interim rates memorandum account to track the difference between the interim rates (which represented an increase of 1.2% over the exiting rates) and the final adopted rates effective January 1, 2021. In October 2021, the CPUC issued Decision No. 21-10-024 adopting the GRC for years 2021, 2022, and 2023. The decision resulted in an overall rate increase of \$7.78 million or 9.10% for 2021, \$4.2 million or 4.41% for 2022, and \$4.3 million or 4.38% for 2023. The Administrative Law Judge’s Ruling in December 2020 also authorized SWS to recover the revenue associated with the delay in adopting new 2021 rates (the difference between the interim rates and the adopted rates). As of December 31, 2021, the regulatory asset related to the interim rates under-collection is approximately \$7.2 million. This regulatory asset is included in both short-term interim rates and long-term regulatory asset-other in the table above.

As permitted by the CPUC, SWS maintains water supply cost balancing accounts. Balancing accounts track pricing differences between noncontrollable costs authorized in rates such as purchased water, purchased power and pump taxes and actual recorded costs, and defers the under-collected amounts for future surcharge (“regulatory assets”), or over-collected amounts for future surcredit (“regulatory liabilities”) to customers. Deferred amounts are charged or credited to customers over a 12-to 36-month period once approved in accordance with the CPUC Standard Practice U-27-W. This Standard Practice requires the Company to accrue interest on its supply cost balancing accounts at the rate prevailing for 90-day nonfinancial commercial paper established by the CPUC.

For the years ended December 31, 2021 and 2020, approximately \$1.2 million and \$7.7 million of net undercollections (including interest), respectively, were recorded in the water supply cost balancing accounts. Amortization of surcharges that are in rates to recover under-collections from customers also decreased the water supply cost balancing accounts, as applicable. During the years ended December 31, 2021 and 2020, approximately \$4.0 million and \$6.0 million of surcharges (excluding interest), respectively, were billed to customers which reduced undercollections in the water supply cost balancing accounts.

As of December 31, 2021, the water supply cost balancing accounts have approximately \$10.2 million in net cost under-collections. Currently, there are surcharges in place to recover approximately \$2.0 million of these under-collections by December 31, 2022. It is considered

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probable that the remaining \$8.2 million will be recovered through a future surcharge allowed by the CPUC.

The low-income ratepayer assistance ("LIRA") program provides monthly credits to qualifying low-income customers. A regulatory asset or liability account captures the net cost of the program that provides monthly credits to qualifying low-income customers in the form of a surcredit, and also related monthly charges to nonqualifying residential customers in the form of a surcharge.

On April 1, 2015, the Governor of California issued an Executive Order that directed the State Water Resources Control Board to impose restrictions on urban water suppliers to achieve a statewide 25 percent reduction in potable urban usage through February 2016. This order was subsequently extended through October 2016. SWS developed a plan in accordance with this directive and received authorization of Schedule no. 141.1-Water Shortage Contingency Plan which went into effect on August 1, 2015. Included in this plan is a drought surcharge which was billed to applicable customers that use more than a prescribed volume of water. This drought surcharge when billed to customers was recorded as a regulatory liability. In August 2016, this drought surcharge was lifted and is no longer billed to customers. The Company recognized revenue of \$0.3 million for the year ended December 31, 2020, to offset Monterey-style Water Revenue Adjustment Mechanism ("Monterey WRAM") under collections. As of December 31, 2021, the drought surcharge regulatory liability balance was \$0.3 million.

Cash and Cash Equivalents

The Company considers all highly liquid investments such as certificates of deposit, commercial paper, and money market accounts with a maturity of three months or less when acquired to be cash equivalents. Cash equivalents are stated at cost, which approximates fair value.

Utility Property, Plant and Equipment

The cost of additions to regulated utility plant includes labor, material, and capitalized overhead. Capitalized interest is not authorized by the CPUC and therefore is not included in asset cost. Depreciation expense on utility plant is recorded using the straight-line method over useful lives ranging from five to fifty years primarily using the composite method of depreciation as prescribed by CPUC. Depreciation expense on average gross depreciable plant was 3.6% for both years ended December 31, 2021 and 2020. In general, upon retirement of the property, the original cost of the property less its salvage value is charged to accumulated depreciation and the cost of removal is charged to the related regulatory liability with no gain or loss recognized.

Maintenance costs are expensed in the period in which they are incurred. Improvements that extend the life of an asset are capitalized. The Company does not accrue for major maintenance projects prior to the periods in which they are actually incurred.

Long-Lived Asset Impairment

The Company assesses finite-lived intangible assets and other long-lived assets, excluding goodwill, for recoverability in accordance with the applicable accounting guidance. Intangible and other long-lived assets are assessed for recoverability whenever events or changes in circumstances indicate that their carrying value may not be recoverable through the estimated undiscounted future cash flows resulting from the use of the assets. If it is determined that the carrying value of intangible assets or other long-lived assets not be fully recoverable, the impairment is measured using the projected discounted cash-flow method.

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Goodwill

Suburban has one reporting unit with \$1.8 million of goodwill related to the acquisition of The City of West Covina's Water Utility System in February 25, 2000. The Company tests goodwill for impairment annually or more frequently if events or circumstances indicate carrying values may not be recoverable. Qualitative factors are first assessed to determine whether a quantitative goodwill impairment test is necessary. If considered necessary, a quantitative test comparing the fair value of a reporting unit with its carrying amount, including goodwill, is performed. If the fair value of a reporting unit exceeds its carrying amount, goodwill of the reporting unit is not impaired. If the carrying amount of a reporting unit exceeds its fair value, an impairment loss shall be recognized in an amount equal to that excess, limited to the total amount of goodwill allocated to that reporting unit. If a quantitative analysis is necessary, the Company evaluates goodwill for impairment using discounted cash flow methodologies, transaction values for comparable companies, and other valuation techniques. There have been no impairments recorded for this goodwill.

Separately identified water rights are included in other long-term assets. The Company has no other indefinite-lived intangible assets.

Inventories

Inventories generally consist of parts and supplies held for use in the ordinary course of business and are valued at the lower of cost or net realizable value generally using the moving average cost method. Where shipping and handling costs are borne by us, these charges are included in inventory and charged to cost of services upon use in construction or the providing of services.

Debt Issuance Costs

Debt issuance costs are amortized to interest expense using the straight-line method over the term of the related debt.

Income Taxes

Income taxes are accounted for using the liability method. Deferred tax assets and liabilities are recorded in order to recognize future tax effects attributable to differences between the financial statement assets and liabilities and their respective tax bases, as well as the recognition of operating loss and tax credit carryforwards. Deferred tax assets and liabilities are recorded using enacted tax rates expected to apply to taxable income in the years in which the temporary differences are recovered or settled. The effect of a change in tax rates on deferred tax assets and liabilities is recognized in the period that the change occurs. The parent company of SouthWest files a consolidated U.S. federal income tax return, which includes all of its subsidiaries (including the Company). Income taxes are allocated to the Company on a separate return basis.

Liabilities are recorded for more likely than not income tax assessments based on estimates of potential tax related exposures. Accounting for these assessments requires significant judgment as uncertainties often exist with respect to existing tax laws, new interpretations of existing laws and rulings by taxing authorities. Differences between actual results and assumptions, or changes in assumptions in future periods, are recorded in the period they become known.

The Company records deferred income taxes for regulatory assets and regulatory liabilities when recovery/refund of these amounts is expected to be allowable in future rates by the CPUC. In addition, investment tax credits are deferred and are amortized over the estimated productive lives of the related assets as allowed by the CPUC.

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Advances for Construction and Contributions in Aid of Construction

Developers, builders, governmental agencies, and municipalities contribute property or cash to extend the Company's water service to their properties. For ratemaking purposes, these contributions in aid of construction ("CIAC") generally serve as a rate base reduction since they represent noninvestor supplied funds. The Company depreciates utility plant funded by contributions and amortizes the CIAC balance as a reduction to depreciation expense, producing a result which is functionally equivalent to reducing the original cost of the utility plant for the contributions. Advances for construction are contributed property or cash which is refundable for limited periods as new customers begin to receive service or other contractual obligations are fulfilled. Advances which are no longer refundable are reclassified to CIAC.

Asset Retirement Obligations

The Company records the fair value of the legal liability for asset retirement obligations ("ARO") associated with its wells and other regulated utility infrastructure. Amounts recorded as asset retirement obligations are subject to various assumptions and determinations, such as determining whether a legal obligation exists to remove assets and estimating the fair value of the costs of removal, when final removal will occur and the credit-adjusted risk-free interest rates to be utilized on discounting future liabilities. Changes that may arise over time with respect to these assumptions will change amounts recorded in the future. Estimating the fair value of the costs of removal are determined based on third party costs.

When the liability is initially incurred, the Company capitalizes the cost of the ARO by increasing the carrying amount of the related long-lived asset. The Company accretes the liability to its estimated future obligation and the capitalized cost is depreciated over the useful life of the related asset. Upon the asset's retirement and the settlement of the ARO, any difference between the cost to retire the asset and the liability recorded is recognized as a gain or loss in the statement of operations.

Revenue Recognition

Most of the Company's revenues are accounted for under the revenue recognition accounting standard, "Revenue from Contracts with Customers - (Topic 606)."

As a nonpublic company, the Company has elected not to apply the quantitative disaggregation of revenue. The Company's revenues are recognized over time as customers simultaneously receive and use the utility services provided. The location of the Company's customers and the types of contracts entered into may affect the nature, amount, timing, and uncertainty of revenue and cash flows. There are no significant financing components or variable consideration.

Revenue is measured based on the amount of consideration specified in the contracts with our customers and excludes any amounts collected on behalf of third parties. We have elected the practical expedient to exclude amounts collected from customers for all sales (and other similar) taxes.

The Company provides water utility services to customers as specified by the CPUC. The transaction prices for water utility revenues are based on tariff rates authorized by the CPUC, which include both quantity-based and flat-rate charges. These contracts contain a single performance obligation, the delivery of water services, as the promise to transfer the individual good or service is not separately identifiable from other promises within the contracts and, therefore, is not distinct. Tariff revenues represent the adopted revenue requirement authorized by

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the CPUC intended to provide the Company with an opportunity to recover its costs and earn a reasonable return on its net capital investment. The annual revenue requirements are comprised of operation and maintenance costs, administrative and general costs, depreciation, and taxes in amounts authorized by the CPUC and a return on rate base consistent with the capital structure authorized by the CPUC.

Water utility revenues include amounts billed to customers on a cyclical basis, which are based on meter readings for services provided. The amounts that the Company has a right to invoice are determined by each customer's actual usage, an indicator that the invoice amount corresponds directly to the value transferred to the customer. Customer bills also include surcharges for cost recovery activities, which represent CPUC-authorized balancing and memorandum accounts that allow for the recovery of previously incurred operating costs. Revenues from these surcharges result in no impact to earnings as they are offset by corresponding increases in operating expenses to reflect the recovery of the associated costs. Unbilled revenues are amounts estimated to be billed for usage since the last meter-reading date to the end of the accounting period.

As authorized by the CPUC, the Company records in revenues the difference between the adopted level of volumetric revenues as authorized by the CPUC for metered accounts (volumetric revenues) and the actual volumetric revenues recovered in customer rates. The difference is tracked under the Monterey WRAM. If this difference results in an under-collection of revenues, the Company records the additional revenue only to the extent that they are expected to be collected within 24 months following the year in which they are recorded in accordance with ASC Topic 980, Regulated Operations.

The Company also recognizes revenue when it is probable that future recovery of previously incurred costs or future refunds that are to be credited to customers will occur through the ratemaking process.

Removal Costs

When the CPUC approves rates which allow recovery in advance for the cost of removal of assets required by the normal on-going maintenance and repair of the water system, the Company recognizes a regulatory liability until the actual costs to retire those assets are incurred.

Recent Accounting Pronouncements

In February 2016, the FASB issued ASU No. 2016-02, Leases, which will require lessees to recognize assets and liabilities arising from operating leases on the balance sheet. Lessees and lessors will be required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach. The modified retrospective approach includes a number of optional practical expedients that entities may elect to apply. These practical expedients relate to the identification and classification of leases that commenced before the effective date, initial direct costs for leases that commenced before the effective date and the ability to use hindsight in evaluating lessee options to extend a lease, terminate a lease or to purchase the underlying asset. In June 2020, the FASB deferred the effective dates for nonpublic entities to annual reporting periods beginning after December 15, 2021 and interim periods within annual reporting periods beginning after December 15, 2022. Earlier application is permitted for all entities. The Company is evaluating the potential impact of this ASU on its financial statements and related disclosures.

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In June 2016, the FASB issued ASU No. 2016-13 on accounting for impairments of financial instruments, including trade receivables, which requires companies to estimate expected credit losses on trade receivables over their contractual life. Historically, companies reserve for expected credit losses by applying historical loss percentages to respective aging categories. Under the updated accounting guidance, companies will use a forward-looking methodology that incorporates lifetime expected credit losses, which will result in an allowance for expected credit losses for receivables that are either current or not yet due, which historically have not been reserved for. In November 2019, the FASB ASU No. 2019-10, Financial instruments -Credit losses (Topic 326), Derivatives and hedging (Topic 815), and Leases (Topic 842) -Effective dates extending the effective dates to annual and interim reporting periods in 2023 for nonpublic entities, with early adoption available. The Company is evaluating the requirements of the updated guidance to determine the impact of adoption.

In August 2018, the FASB issued ASU No. 2018-13, which modifies the disclosure requirements on fair value measurements. The modifications in this update eliminates, amends, and adds disclosure requirements for fair value measurements, which is expected to reduce costs for preparers while providing more decision-useful information for financial statement users. The updated accounting guidance is effective for fiscal years beginning after December 15, 2019, with early adoption available. The adoption of this standard on January 1, 2020 did not have a material impact on the Company's financial statements and related disclosures.

In December 2019, the FASB issued ASU No. 2019-12, Income Taxes (Topic 740) -Simplifying the Accounting for Income Taxes. The amendments in this update simplify the accounting for income taxes by removing certain exceptions and clarifying certain requirements regarding franchise taxes, goodwill, consolidated tax expenses, and annual effective tax rate calculations. For nonpublic entities, the ASU is effective for fiscal years beginning after December 15, 2022. Early adoption is permitted. The Company is evaluating the impact of this ASU on its financial statements.

3. Utility Property, Plant and Equipment

Utility property, plant, and equipment, recorded at cost, consist of the following at December 31:

<i>(in thousands of dollars)</i>	2021	2020
Land and land rights	\$ 1,140	\$ 1,140
Source of supply	18,375	18,250
Pumping and purification	43,538	39,084
Transmission and distribution	264,775	251,892
General plant	39,561	37,266
Cost of assets in service	<u>367,389</u>	<u>347,632</u>
Accumulated depreciation and amortization	<u>(138,547)</u>	<u>(129,515)</u>
Net utility plant in service	228,842	218,117
Construction work-in-progress	<u>23,615</u>	<u>13,975</u>
Utility property, plant and equipment, net	<u>\$ 252,457</u>	<u>\$ 232,092</u>

Separately identified water rights are included in other long-term assets.

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Depreciation and amortization expense for regulated utility property, plant and equipment totals \$11.7 million and \$10.8 million in 2021 and 2020, respectively. Depreciation expense was reduced by the amortization of contributions in aid of construction totaling \$1.0 million in both 2021 and 2020.

Substantially all of the Company's utility property, plant and equipment are pledged as collateral for the long-term debt obligations (see Note 6).

4. Current Assets

Accounts Receivable

Accounts receivable includes \$3.2 million and \$3.4 million of accrued unbilled revenue at December 31, 2021 and 2020 respectively. The Company maintains allowances for doubtful accounts for receivables deemed uncollectible based on management's periodic review of past due or delinquent accounts. Accounts receivable are net of allowance for doubtful accounts of \$2.7 million and \$1.6 million at December 31, 2021 and 2020, respectively.

Other Current Assets

Other current assets consist of the following at December 31:

<i>(in thousands of dollars)</i>	2021	2020
Materials and supplies inventory	\$ 539	\$ 487
Cyclic storage/prepaid water leases	3,181	5,741
Prepaid expenses	153	132
Other	527	204
Total other current assets	<u>\$ 4,400</u>	<u>\$ 6,564</u>

5. Other Assets

Goodwill

The carrying amount of goodwill was \$1.8 million at both December 31, 2021 and 2020. The Company determined that goodwill was not impaired at December 31, 2021 or 2020.

Other Long-Term Assets

Other long-term assets consist of the following at December 31:

<i>(in thousands of dollars)</i>	2021	2020
Plant held for future use	\$ 2,040	\$ 1,539
Water purchase rights	5,085	5,070
Other	1,328	1,268
Total other long-term assets	<u>\$ 8,453</u>	<u>\$ 7,877</u>

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6. Long-Term Debt

Long-term debt consists of the following at December 31:

<i>(in thousands of dollars)</i>	2021	2020
9.09% series B first mortgage bond due 2022	\$ 8,000	\$ 8,000
5.64% series D first mortgage bond due 2024	15,000	15,000
6.30% series E first mortgage bond due 2026	10,000	10,000
4.42% series F first mortgage bond due 2035	25,000	25,000
3.70% series G first mortgage bond due 2059	<u>32,000</u>	<u>32,000</u>
Total long-term debt payment obligations	90,000	90,000
Unamortized deferred financing cost	<u>(609)</u>	<u>(690)</u>
Total long-term debt	89,391	89,310
Less: Current portion of long-term debt	<u>(8,000)</u>	<u>-</u>
Long-term debt less current portion	<u>\$ 81,391</u>	<u>\$ 89,310</u>

First Mortgage Bonds

Interest on the above first mortgage bonds is payable semiannually and bonds may be redeemed at any time prior to the maturity at par plus a call premium. Additional mortgage bonds may be issued subject to the provisions of the mortgage bond indentures and SouthWest revolving credit facility and senior notes. Substantially all of the utility plants of the Company were pledged as collateral for these bonds. The mortgage bond indentures limit the amount of cash and property dividends that the Company may pay SouthWest related to its common stock investment. Common stock dividends paid to SouthWest was \$6.0 million and \$6.3 million for years ended December 31, 2021 and 2020, respectively, and are less than the dividend restriction threshold by \$33.8 million at December 31, 2021. At December 31, 2021, the Company was in compliance with the dividend limitations mandated in their respective indentures. In addition, the Company is required to maintain minimum earnings before interest and taxes to interest charges ratio and has not exceeded a ratio of debt to capitalization as required by the respective bond indentures. The Company is subject to additional financial covenants under the terms of the indenture and was in compliance with these covenants at December 31, 2021 and 2020.

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Aggregate Maturities

Total annual maturities of debt outstanding at December 31, 2021 are as follows:

<i>(in thousands of dollars)</i>	Annual Maturities
2022	\$ 8,000
2023	-
2024	15,000
2025	-
2026	10,000
2027 and thereafter	57,000
Total annual maturities	<u>\$ 90,000</u>

7. Other Current Liabilities

Other current liabilities and deferred credits consist of the following at December 31:

<i>(in thousands of dollars)</i>	2021	2020
Purchased water and power accrual	\$ 6,852	\$ 6,061
Franchise and other taxes	2,664	2,645
Accrued salaries, wages and benefits	1,423	1,277
Accrued bond interest payable	814	814
Current portion of advances for construction	296	294
Other	502	703
Total other current liabilities	<u>\$ 12,551</u>	<u>\$ 11,794</u>

Other Long-Term Liabilities

Other long-term liabilities consist of the following at December 31:

<i>(in thousands of dollars)</i>	2021	2020
Unamortized investment tax credits	\$ 62	\$ 73
Deferred rent expense	35	-
Asset retirement obligation	245	232
Other	216	307
Total other long-term liabilities	<u>\$ 558</u>	<u>\$ 612</u>

Asset Retirement Obligations

As described in Note 1, the Company records obligations for the fair value of the legal liability for asset retirement obligations associated with its wells and other regulated utility infrastructure.

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The following is a reconciliation of the beginning and ending aggregate carrying amount of asset retirement obligations, which is included in “Other Long-Term Liabilities” on the balance sheets as of December 31, 2021 and 2020:

<i>(in thousands)</i>	Total
Obligation at December 31, 2019	\$ 221
Accretion	11
Obligation at December 31, 2020	232
Accretion	13
Obligation at December 31, 2021	<u>\$ 245</u>

8. Income Taxes

The components of the provision for income tax expense (benefit) are as follows:

<i>(in thousands of dollars)</i>	2021	2020
Current		
Federal	\$ 2,390	\$ 2,500
State	1,119	1,203
Total current	<u>3,509</u>	<u>3,703</u>
Deferred		
Federal	87	(176)
State	7	(240)
Total deferred	<u>94</u>	<u>(416)</u>
Total provision for income taxes	<u>\$ 3,603</u>	<u>\$ 3,287</u>

A reconciliation of the statutory federal income tax rate to the Company’s effective tax rate is as follows:

	2021	2020
Provision computed at statutory rates	21 %	21 %
State income taxes, net of federal tax benefit	6	5
Rate change	(1)	(2)
Other, net	(2)	(2)
Effective tax rate	<u>24 %</u>	<u>22 %</u>

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Deferred tax assets and liabilities consist of the following at December 31:

<i>(in thousands of dollars)</i>	2021	2020
Deferred tax liabilities		
Depreciation	\$ 19,555	\$ 18,059
Section 1031 like-kind property exchange gain	145	173
Supply cost balancing accounts	3,148	3,991
Gain on condemnation of land	22	25
Deferred debt expenses	4	4
Other	32	29
Total deferred tax liabilities	<u>22,906</u>	<u>22,281</u>
Deferred tax assets		
Advances for construction & CIAC	5,235	5,360
Interest during construction	1,567	1,427
Gross-up on tax rate change	1,359	1,446
Acquisition cost	131	-
Investment tax credits	16	19
Reserves	70	443
Total deferred tax assets	<u>8,378</u>	<u>8,695</u>
Net deferred tax liabilities	<u>\$ 14,528</u>	<u>\$ 13,586</u>

Based upon the Company's current and historical pre-tax earnings, management believes it is more likely than not that the Company will realize the benefit of its deferred income tax assets. Management believes the existing net deductible temporary differences will reverse during periods in which the Company generates net taxable income. However, there can be no assurance that the Company will generate any earnings or any specific level of continuing earnings in future years. Management regularly reviews the recoverability of deferred income tax assets and has determined that no valuation allowances are necessary at December 31, 2021.

The Company is subject to federal and various state and local income taxes. Tax regulations within each jurisdiction are subject to the interpretation of related tax laws and regulations and require significant judgment to apply. State and local income tax returns from 2017 to the present and federal income tax returns from 2018 to the present are still subject to examinations by taxing authorities.

At December 31, 2021 and 2020, the Company has no liabilities for uncertain tax positions.

In response to the COVID-19 pandemic, President Donald Trump signed into law the Coronavirus Aid, Relief, and Economic Security ("CARES") Act on March 27, 2020. The CARES Act provides numerous tax provisions and other stimulus measures, including temporary changes regarding the prior and future utilization of net operating losses, temporary changes to the prior and future limitations on interest deductions, temporary suspension of certain payment requirements for the employer portion of Social Security taxes, technical corrections from prior tax legislation for tax depreciation of certain qualified improvement property, and the creation of certain refundable employee retention credits. The Company evaluated the provisions of the CARES Act and

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concluded that the associated impacts do not have a material effect on its financial position or liquidity.

9. Stockholder's Equity

Common and Preferred Stock

The Company is authorized to issue 500,000 common shares with a par value of \$5.00 per share, of which 149,076 shares were issued and outstanding at December 31, 2021 and 2020. The Company is authorized to issue 180,000 preferred shares with a par value of \$50.00 per share, of which 43,844 Series A preferred shares were outstanding at December 31, 2021 and 2020. Series A preferred stockholders are entitled to annual dividends of \$2.63 per share. There were 35,802 Series B preferred shares issued and outstanding at December 31, 2021 and 2020. The holders of Series B preferred stock are entitled to annual dividends of \$1.50 per share. The holders of common shares are entitled to annual dividends after all the preferred shareholders are paid. All dividends have been paid in full and no dividends are in arrears. All issued and outstanding common and preferred shares of the Company are owned by SouthWest.

10. Related Party Transactions

All collections received by the Company are deposited into SouthWest's bank account on a periodic basis. All disbursements of cash on behalf of the Company are made by SouthWest. The Company recorded a related party payable to SouthWest of \$17.7 million to reflect the net activity as of December 31, 2021. In December 2020, SouthWest made a capital contribution of \$22.4 million to the Company. The average annual interest rates on the intercompany balances was 5.0% for both years ended December 31, 2021 and 2020. Interest expense to SouthWest totals \$0.3 million and \$0.9 million in 2021 and 2020, respectively.

SouthWest performs various management services for the Company, including financial, treasury, risk management services, corporate secretary services, human resources support, income tax preparation and legal support services. The amounts charged to the Company represent both direct and indirect costs. Indirect costs are allocated to the Company based on an allocation formula developed by SouthWest. The Company was allocated management fees of \$7.9 million and \$8.7 million as of December 31, 2021 and 2020, respectively, which is classified as other operating expenses on the statements of income.

11. Commitments and Contingencies

Lease Commitments

The Company leases office facilities and property under operating leases and equipment under parent company leases that expire through 2050. Aggregate rental expense under all operating leases was \$0.8 million and \$0.7 million for the years ended December 31, 2021 and 2020, respectively.

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At December 31, 2021, the future minimum commitments under existing operating leases are as follows:

(in thousands of dollars)

Year ending December 31,		
2022	\$	577
2023		575
2024		567
2025		548
2026		497
2027 and thereafter		1,627
		1,627
Total minimum payments required	\$	4,391

Legal Proceedings

Environmental Matters

Some of the groundwater sources for the Company have been affected by the presence of certain groundwater contaminants. These contaminants consist mainly of chemicals disposed of by various industrial companies in the 1940s and 1950s. In 2001 and 2002, this contamination necessitated the shutdown of a number of the Company's wells, and the Company purchased replacement water at a cost substantially higher than the cost of water pumped from its own wells. Prior to May 2002, these costs were recorded as operating expenses and reduced the Company's operating income.

In May 2002, a settlement agreement was reached between some of the parties allegedly responsible for the contamination ("Cooperating Respondents") and certain water entities, including the Company. As a result of this settlement agreement, the Company received payments during the last several years, and expects to continue to receive payments until completion of remediation.

These payments represent the incremental cost of purchasing water over the cost that would have been incurred by the Company to pump water from its wells had they not been shut down as a result of contamination. The settlement agreement provided for ongoing reimbursement of the Company's excess water costs and the Company bills and collects this reimbursement monthly. These monthly reimbursements are recorded as a reduction to operating expenses. The reimbursements were \$1.2 million and \$0.7 million in 2021 and 2020, respectively.

The settlement agreement also provides for contributions by the Cooperating Respondents for construction of new wells and interconnections with nearby water sources. For 2021 and 2020, there were no contributions, and no contributions were recorded as contributions in aid of construction.

Other Matters

The Company is also involved in other routine legal and administrative proceedings arising during the ordinary course of business. The Company believes that the ultimate disposition of such matters will not have a material adverse effect on its financial position, results of operations or cash flows. Any related legal costs are expensed when incurred.

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12. Employee Benefit Plans

401(k) Retirement Plans

Substantially all employees of the Company are eligible to participate in the 401(k) retirement plan SouthWest sponsors, which is a defined contribution plan. SouthWest makes discretionary matching contributions to the plan that vest immediately. The Company's expense related to SouthWest's matching contribution was \$0.8 million and \$0.7 million for years ended December 31, 2021 and 2020, respectively.

13. General Rate Case

In March 2020, the Company filed an application for a GRC with the CPUC for authority to increase rates charged for water service by \$14.3 million or 17.33% in 2021, by \$5.8 million or 6.04% in 2022, and by \$5.8 million or 5.70% in 2023. The scheduled January 1, 2021 effective date of new rates was delayed by the CPUC. In December 2020, the CPUC approved interim rates and approved an interim rates memorandum account for the purpose of tracking the difference between the interim rates (which represented an inflationary increase of 1.2% over the existing rates) and the final adopted rates scheduled to be effective retroactively to January 1, 2021.

In October 2021, the CPUC issued Decision No. 21-10-024 adopting rate increases in 2021, 2022, and 2023. The decision results in an overall rate increase of \$7.8 million or 9.10% for 2021, \$4.2 million or 4.41% for 2022, and \$4.3 million or 4.38% for 2023.

In November 2021, the CPUC authorized the company to implement the 2022 step rate increase of \$4.2 million or 4.41% for 2022, and \$4.3 million or 4.38% for 2023.

14. Subsequent Events

The Company's management has evaluated events and transactions in these financial statements after December 31, 2021 through April 14, 2022, which is the date these financial statements were available to be issued. Based on our evaluation, there were no other material events or transactions which required disclosure.